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Ms. Marlene H. Dortch, Secretary
Federal Communications Commission
445 Twelfth Street, SW
Washington, DC 20554

Re: Notice of Oral *Ex Parte* Communication
***Connect America Fund*, WC Docket No. 10-90**
***A National Broadband Plan for Our Future*, GN Docket No. 09-51**
***High-Cost Universal Service Support*, WC Docket No. 05-337**
***Developing Unified Intercarrier Compensation Regime*, CC Docket No. 01-92**
***Federal-State Joint Board on Universal Service*, CC Docket No. 96-45**

Dear Ms. Dortch:

We submit this notice in compliance with Section 1.1206(b) of the Commission's rules.

On Friday July 29th, I spoke by phone with Margaret McCarthy, Policy Advisor for Wireline issues to Commissioner Copps, and separately with Angela Kronenberg, Wireline Legal Advisor to Commissioner Clyburn. In both instances, we discussed Free Press' initial reaction to the Universal Service Fund proposal submitted by a coalition of price-cap incumbent carriers, and a separate proposal submitted by a coalition of rate-of-return carriers (together, the "joint industry framework").

As I noted during the call, Free Press was still reviewing the details of the proposal, and is continuing to analyze the fine print. However, I emphasized several troubling components of the proposal.

- <u>The joint industry framework does not adequately reform the USF:</u> The claim by the companies and trade associations that these parallel proposals represent "reform" of the USF system, as envisioned in the National Broadband Plan, is highly misleading. These proposals merely represent each group – large price-cap incumbents and small rate-of-return incumbents – putting forth a plan that promotes that group's own self-interest, at the expense of consumers and small wireless carriers.
- <u>The joint industry framework merely shifts support from competitive carriers to the large price-cap incumbent carriers without addressing actual need for subsidies:</u> Currently, price-cap incumbent carriers receive about $500 million in annual High Cost Fund support, or about 12 percent of the total. Under the joint industry framework, this support would increase to $2.2 billion, or half of the total. This shift is accomplished largely through the redistribution of the current funding allocated to competitive eligible

telecommunications carriers (CETCs), who in most cases are wireless providers. While there is a legitimate criticism of the existing method for supporting CETCs, the joint-industry framework appears to be more concerned with outcomes for carriers, not outcomes for consumers.

- The joint industry framework has no meaningful reform of the USF for rate-of-return carriers: Under the joint industry framework, the current broken system of treating rural rate-of-return carriers different from larger, "non-rural" price-cap carriers continues. The plan does nothing to reform the inefficiencies and perverse incentives inherent in the historical cost support methodology, nor to adequately address inflated rates of return. For example, it would continue to subsidize the entire cost of a triple-play capable rural telecommunications network while only accounting for the revenues earned on the regulated voice services. Not surprisingly, the rural carriers' preferred framework would not subject themselves to any cost-containment, and their plan explicitly contemplates that these carriers' draw on the USF High Cost Fund would grow overtime.

- The joint industry framework unfairly raises basic telephone rates on all consumers: Under the joint industry framework, carriers are allowed to increase the current $6.50 per month Subscriber Line Charge (SLC) by $3.75. The rationale for this increase is that the loss of implicit subsidies in the form of mandated terminating access charge reductions must either be offset by explicit subsidies or recovered from end-users. While we fully understand the need for rate-regulated companies operating in rural high cost areas to recover costs, increasing the subscriber line charge for *all* basic telephone consumers is a poor and overly broad method for cost recovery, and one that will unjustly enrich the largest carriers. For example, Verizon as a large ILEC and long-distance carrier stands to save billions each year as a result of having to pay lower access charges for terminating calls. However, as an ILEC, they will be able to raise the monthly SLC for *all* of their customers, including those customers who live in urban areas where cost-recovery is already more than adequate. The purpose of the SLC is to recover the federal portion of the cost of the local-loop, ensuring that carriers earn their common line revenue requirement. When the FCC last raised the SLC in the *CALLS Order*, cost-recovery studies indicated that if the SLC were set at $6.50, carriers would *over-recover* costs on approximately 82 percent of residential and single-line business price-cap lines. Because of substantial improvements in technology, this 10-year old result likely underestimates the proportion of lines that are over-recovering today. Therefore, it appears that a $3.75 primary line SLC increase would be far too high, as it would not only offset the full value of moving to a lower terminating access rate (e.g. a reciprocal rate), but would also fail to account for the *current* level of SLC over-recovery. Therefore, Free Press would prefer that the Commission revisit these cost studies in a comprehensive manner prior to implementing any SLC increases. The price cap carriers argue that just because the cap on the SLC will increase, that this does not necessarily mean that carriers will raise these charges, because, as the carriers claim, competition will be enough to hold prices down. However, this belief is not warranted, as the FCC's own historical data reveals that price cap regulated carriers continually increased SLC fees over the past decade, and many currently charge at or near the maximum. Other evidence indicates that even competitive LECs not subject to the SLC cap charge fees at or above the federal maximum.

- The joint industry framework would completely remove all consumer protections and regulatory obligations of price-cap carriers, and would result in no meaningful oversight of the billions of dollars in Connect America Fund monies awarded to these carriers: Buried in the price-cap carriers' proposal is the requirement that the FCC completely eliminate all Carrier of Last Resort obligations (COLRs) for *all* price-cap carriers (whether or not they participate in the CAF), and it would completely remove all obligations placed on these Eligible Telecommunications Carriers (ETCs) by Congress in Section 214 of the Communications Act. In addition, the plan requires that the FCC "eliminate all remaining federal rate and other service regulations imposed on price-cap incumbent LECs." This is simply stunning. Not only have these carriers crafted a plan that nearly quadruples their USF support, but the social cost for doing this is higher prices for all consumers and the elimination of any and all federal regulation of these monopoly utility services. Apparently it is not enough for these incumbents that the prices for even their subsidized broadband services will not in anyway be monitored to ensure no unjust enrichment; they also want to be able to raise rates on legacy monopoly services for tens of millions of captive customers who have no other viable options.

- The access replacement fund is merely another unjustified subsidy: The point of reforming the USF is to direct subsidies where they are needed in order to ensure all Americans have access to advanced telecommunications services of comparable quality and price. The point of the USF, as articulated in Section 254, *is not to ensure the profitability of telecom carriers in perpetuity*. Subsidies should be based on actual need. This is why the access replacement fund is misguided. It merely exists to ensure already unnecessary subsides continue, albeit under a different name. No carrier, rate of return nor price-cap, has demonstrated that the access replacement fund is necessary. And though the price-cap carriers' plan calls for the fund to be phased out after five years, we remind the FCC that the same promise was made about the Interstate Access Support mechanism, a $650 million annual fund designed to replace lost access revenues resulting from the *CALLS Order*. That fund was supposed to disappear in 2005, and the latest Commission proposal again calls for its elimination. Yet ratepayers have given more than $4 billion to price-cap carriers for this existing "temporary" replacement fund since it was due to expire, with no explanation from the FCC on why, or if the mechanism is even needed anymore. This history of a broken process is why members of Congress and the public have called for USF reform, and all it would take is the FCC simply doing cost studies to ask and answer the basic question: where are subsidies needed to ensure that supported services will be available at reasonable qualities and rates. If the FCC actually studied this question, instead of letting industry write its own rules, it might find that the size of the USF is already far in excess of what is needed.

We look forward to analyzing this joint-industry proposal in the weeks ahead, and hope that the Commission treats it as one among many ideas for USF reform, not a *fait acompli* to be rubber-stamped and approved in the name of political expediency.

Very truly yours,

_______/s/_____________

S. Derek Turner
Research Director
Free Press

cc: Margaret McCarthy
Angela Kronenberg